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ARIZONA CORPORATION COMMISSION

Brian C. McNeil
Executive Secretary

Direct Line: (602) 542-4143
Fax: (602) 542-0765
E-mail kmayes@cc.state.az.us

July 12, 2005

Re: TEP Rate Case; Docket No. E-01933A-04-0408

Dear Parties to the Docket:

I write to pose several questions about Tucson Electric Power Company's ("TEP") rate review filing in this docket. These questions stem from my review of TEP's application as well as my review of the failed buyout of UniSource Energy Corporation in Docket No. E-04230-03-0933.

Specifically, there are three issues that I believe warrant close consideration during the ongoing 2004 Tucson Electric Power rate review. Totalling nearly \$200 million in assets, these three elements – FAS 143 Refund, Valencia Sales Tax and Capital Lease Income – would appear to have an important potential impact on TEP's revenue requirement.

FAS 143 Refund

It is my understanding that, due to a change in accounting practices – from FAS 143 issued by the Financial Accounting Standards Board ("FASB") – there may have been a post-tax windfall for TEP regarding the final decommissioning of generation assets. TEP has collected significant funds from ratepayers for final decommissioning of its assets. I would like the parties to the 2004 rate review to recommend whether any windfall should be refunded to ratepayers and/or whether TEP has a legal obligation to return these funds to ratepayers.

Valencia Sales Tax

In August of 1999, TEP settled with the Arizona Department of Revenue possibly stemming from several cases in Maricopa County Superior Court, including Docket Nos. TX1990-001686, TX1994-000923 and TX1995-001047. All of these dockets involved TEP as a plaintiff and all of these cases were dismissed – with prejudice – in October of 1999. The purpose of the settlement was to eliminate the utility's ongoing sales-tax liability from the gross income of a subsidiary dating back to as early as 1985. The subsidiary, Alamito Company, is one of the reasons TEP was pushed to the brink of bankruptcy, a condition that ultimately led to rate increases in 1991. I would like the parties to address the question of why current ratepayers should be obligated to pay back taxes from a TEP subsidiary whose failure factored into the near

collapse of the company, which in turn required a bailout by ratepayers. Is this liability better placed with shareholders?

Capital Lease Income

Finally, the company has made certain investments in entities that hold some of TEP's capital leases and that these capital leases are recorded in a plant account as rate base in TEP's filing. I am specifically referring to page 200 of FERC's Form No. 1, line 4, which lists \$747,553,438 as Property Under Current Leases, included in account 101.1 and provided in Schedule E of TEP's rate review filing. While the costs of capital leasing are included in cost of service, I am concerned that the earnings – which I understand could be several million dollars – from this type of cross-investment have not been factored into the overall revenue requirement. I would like the parties to the rate case to address the question of whether these proceeds should be offset against operating lease costs.

The combined assets under consideration in these three scenarios total a significant percentage of TEP's estimated 2004 rate base plus cost of service, and as a result, may reflect directly on the determination of whether TEP is over-earning.

Thank you for your attention to these questions.

Sincerely,



Kris Mayes
Commissioner

cc: Chairman Jeff Hatch-Miller
Commissioner Marc Spitzer
Commissioner William Mundell
Commissioner Mike Gleason
Ernest Johnson